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BEFORE THE
SURFACE TRANSPORTATION BOARD

STB Ex Parte No. 582 (Sub-No.1)

MAJOR RAIL CONSOLIDATION PROCEDURES

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COMMENTS OF WESTERN RESOURCES, INC.

Western Resources, Inc. ("Western"), a generator of electricity that ships approximately 11 million tons of coal by rail from mines in the western United States to Western's coal-fired facilities in Kansas, hereby offers the following comments in response to the Advance Notice of Proposed Rulemaking ("ANPR") served in this docket on April 6, 2000. Western is also filing comments in response to the ANPR jointly with several other coal shippers. *See* Joint Comments of Certain Coal Shippers ("Joint Comments"). Western's comments submitted herein are in addition to the issues raised in the Joint Comments.

I.
Identity of Western Resources, Inc.

Western is a consumer services company headquartered in Topeka, Kansas with interests in monitored security and energy. Western's utilities, KPL and KGE, provide electric service to approximately 620,000 customers in Kansas. Western owns several coal-fired electric generating stations that in total burn approximately 11 million tons of coal each year that must be delivered by the BNSF and UP. Western's Jeffrey Energy Center, in St. Mary's, Kansas northwest of Topeka, alone requires approximately nine million tons of coal each year to provide electricity to satisfy the needs of Western's wholesale and retail customers. This coal is delivered by the Union Pacific Railroad Company ("UP") and the Burlington Northern and Santa Fe Railway Company ("BNSF") in a joint line contract movement from mines in the Powder River Basin in Wyoming. Western's Lawrence and Tecumseh Energy Centers, located on the line of BNSF between Topeka and Kansas City, each presently burn around one million tons of coal per year which is delivered by the UP and BNSF from mines in Colorado in joint line service. Reliable, reasonably priced rail service is therefore essential to Western's utility operations.

Western's generating stations are captive to either BNSF or UP for part of the overall transportation. At Jeffery, the BNSF has a monopoly over the Northern Wyoming Powder River Basin coal mines that supply this facility, and the UP has a monopoly over the destination portion of the movement. At Lawrence and Tecumseh, BNSF obtained a monopoly over the destination portion of the movement to these facilities as a result of the merger of the Burlington Northern Railroad Company ("BN") and The Atchison, Topeka & Santa Fe Railway Company ("Santa Fe").

II.

Comments in Response to the ANPR

The operation of Western's electric generating plants has been directly and negatively impacted by the merger of the Burlington Northern Railroad Company ("BN") and The

Atchison, Topeka & Santa Fe Railway Company ("Santa Fe")[1], and the merger of the Union Pacific Railroad Company ("UP") and the various rail lines making up the Southern Pacific lines ("SP").[2] The adverse impacts to Western have substantial in both an economic and operational sense. Western participated as a Party of Record in each of those merger proceedings, and it intends to also participate as a Party of Record in any proceeding involving a proposed merger of BNSF or UP and another rail carrier, including the proposed merger of BNSF and Canadian Railways, et al. ("CN").

The disappointing and costly efforts to implement the most recent major railroad mergers, were extensively chronicled for the Board by the hundreds of rail shippers that submitted oral and written testimony in Ex Parte 582, *Public Views on Major Rail Consolidations*. Indeed, in the testimony to the Board during the hearing in Ex Parte 582, the Chairman of the UP, Mr. Richard Davidson, candidly admitted that service on the UP system was <u>still</u> recovering from its severe problems in 1997 and 1998.

The record in that proceeding left little doubt that the nation should expect the next rail merger, whether it is the proposed merger of BNSF and CN or if it is a merger involving BNSF or UP and any of the other Class I railroads, will result in significant service disruptions and economic losses to rail customers, many of whom are like Western in that they are still suffering the ill-effects of recent rail mergers. Moreover, the railroad mergers that have occurred to date

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[1] ICC Finance Docket No. 32549, *Burlington Northern, Inc. and Burlington Northern Railroad Company – Control and Merger – Santa Fe Pacific Corporation and The Atchison, Topeka & Santa Fe Railway Company*, decision served August 23, 1995.

[2] STB Finance Docket No. 32760, *Union Pacific Corporation, Union Pacific Railroad Company and Missouri Pacific Railroad Company – Control and Merger – Southern Pacific Rail Corporation, Southern Pacific Transportation Company, St. Louis Southwestern Railway Company, SPCSL Corp., and The Denver and Rio Grande Western Railroad Company*, decision No. 44 (served August 12, 1996) ("UP/SP Merger Decision").

have produced a rail system where competition between major railroads has been reduced, rail service has become undependable, and the railroads have indicated that the solution to their problems is to retrench, restrict capacity, concede business to modes of transportation their mergers were supposed to take business from, and begin to move away from contract service and raise the rail rates of shippers who have no choice but to use the railroad to move their commodities. This cannot be what the STB expected from the rail mergers it has approved, but these problems will carry over to future mergers, and will in all likelihood be exacerbated by the increased size of the rail systems involved and the increased concentration of market power into the hands of fewer major players, unless substantive changes are made to the Board's "merger rules" to enhance competition in the railroad industry. The Board has concluded its "merger rules" must be revised because they are inadequate to addressing the concerns associated with reviewing proposals that would lead to two transcontinental railroads. See ANPR, Slip Op. at 2. However, such concerns exist now, since the rail industry in the United States is essentially comprised of two two-railroad systems in the western and eastern United States.

In the ANPR, the Board also concluded that "the time has come" for it to consider whether its rail merger policy should be revised "with an eye toward affirmatively enhancing, rather than simply preserving, competition." *Id.* at 4. The Joint Comments submitted by Western and other coal shippers outline several changes to existing regulations that should be included in the Notice of Proposed Rulemaking ("NOPR") to be issued in this proceeding in order further such a policy. In these separate comments Western adds another change that should be included in the NOPR to improve the nation's rail system and further a rail merger policy of increasing rail competition and quality of rail service for all rail customers as the industry continues to consolidate.

In addition to the regulatory changes set forth in the Joint Comments, Western requests the Board to include in the NOPR proposed regulations that expand upon the authority of the Board in merger proceedings to modify the terms of existing contractual arrangements between rail customers and railroads if all or part of the contract is contrary to the policy goal of affirmatively enhancing competition and improving rail service for all rail customers after a merger. A large percentage of rail transportation moves under rail transportation contracts, and most coal is moved under rail transportation contracts. This makes the consideration of rail service that moves under contract an important component of advancing a new rail merger policy. The dominance of rail transportation covered by contract means that such contract service can thwart the advancement of rail merger policy unless rail transportation contracts are modified. The Board took exactly this step in the UP/SP merger proceeding, when it required nationwide application of a more limited agreement between the Chemical Manufacturers Association and the merger applicants whereby the applicants agreed, upon consummation of the merger to "modify any contract with shippers at 2-1 points in Texas and Louisiana to allow BNSF access to at least 50% of the volume." See UP/SP Merger Decision at 146. Specifically, the Board required as a condition of its approval of the UP/SP merger "that this provision be modified by extending it to shippers at <u>all</u> 2-to-1 points incorporated within the BNSF agreement, <u>not just 2-to-1 points in Texas and Louisiana</u>" *Id.* (emphasis added). The Board did not cite the statutory authority it relied upon to take this action in the UP/SP merger. Subsequently, however, in the Conrail breakup proceeding the STB specifically relied on 49 U.S.C. 11321, coupled with the broad conditioning authority of 49 U.S.C. 11324(c), to temporarily override the antiassignment provisions of certain contracts between shippers and carriers. In that proceeding the Board stated that, pursuant to § 11321, it may override other laws as necessary to carry out a merger as approved by the Board. STB Finance Docket No. 33388, *CSX Corporation and CSX Transportation, Inc., Norfolk Southern Corporation and Norfolk Southern Railway Company – Control and Operating Leases/Agreements – Conrail Inc. and Consolidated Rail Corporation*, Decision No. 89 (served July 23, 1998) at 72-74. In doing so, the STB rejected arguments that 49 U.S.C. 10709 prohibited the Board from modifying contracts between shippers and railroads in the context of furthering the Board's rail merger policy, stating, "there is no indication, however, that section 10709 was intended to limit the agency from preempting contracts as necessary to carry out a merger other transaction that we approve under section 11323-24." *Id.*

More recently, the Board has been asked to exercise its contract modification authority as part of a request to reopen the BN/Santa Fe merger for the purpose of rectifying the alleged failure of a merger condition designed to preserve competition at a "2-to-1" point. Verified Petition to Reopen of Roquette America, Inc., filed February 14, 2000 in Finance Docket No. 32549, *Burlington Northern Inc. and Burlington Northern Railroad Company -- Control and Merger -- Santa Fe Pacific Corporation and The Atchison, Topeka, and Santa Fe Railway Company*. In that proceeding, petitioner has asked the Board to override a contract that was allegedly negotiated under non-competitive circumstances due to the failure of the merger condition.

Finally, it is apparent that the Board has the authority to override or modify existing contractual arrangements as part of its authority under 49 USC § 11123 to issue service orders to rectify severe service disruptions. See Supplemental Order No. 1 to STB Service Order No. 1518, *Joint Petition for Service Order*, served December 4, 1997, at 2. (where Board "directed UP/SP to release from their contracts all shippers capable of being switched by [the Port

Terminal Railroad Association] at Houston that desire to be served by [the Texas Mexican Railway Company]").

The Board, therefore, clearly has the authority under 49 U.S.C. § 11321 and § 11123 to modify rail transportation contracts to the extent such modification is needed to carry out its merger policies regarding competition and service as applied to a particular merger transaction. This authority should be actively utilized as the Board revises its policies and rules to facilitate the enhancement of competitive alternatives and service for captive shippers in order to ensure that all captive shippers benefit from this policy.

More specifically, in the case of coal shippers, there are some facilities, such as Western's Jeffery Energy Center, that are captive and that also have long-term coal transportation contracts in effect whose terms began even prior to the merger of BNSF and will extend several years into the future. These long-term captive shippers are the most harmed by the inability of railroads to implement mergers because they do not have alternatives to alleviate the significant adverse effects of service deterioration. Moreover, their contracts may, or they may not, provide a means to recover the substantial economic damages caused by reductions in service after a rail merger or seek alternative transportation services from other carriers. As Entergy and Western have recently experienced through their pending cases against UP, these shippers usually must engage in contentious, expensive, and drawn out litigation to determine the answer to this question.

Consequently, the preclusion of captive shippers with long-term transportation contracts from taking advantage of any pro-competitive changes made through this proceeding to the Board's rule governing rail mergers until their contract expired would have significant adverse economic results. For example, it is not unreasonable to expect that the improvement of rail service to shippers utilizing the new rules would come at the expense of deteriorated service to captive shippers who, because their transportation is under contract, do not have the same recourse to the agency. In addition, a shipper that entered into a long-term high priced contract because of the lack of competition to its plants would be unfairly forced to continue an arrangement negotiated under those conditions while the transportation costs of other shippers would be expected to receive the merger benefits of rate reductions, productivity and efficiency gains, thus placing the shipper with a long-term contract at a significant competitive disadvantage in its industry through no fault of its own.

If the Board is to revise its merger policy with the aim of enhancing rail competition systemwide and improve rail service for all rail shippers - and Western fully supports this policy change - it is entirely appropriate and necessary for the Board to exercise its authority, as part of its merger application review process, to oversee the modification of contracts between a merging railroad and its rail customers to ensure that the service to these facilities is competitively priced and on a par with service provided to other rail shippers under the Board's regulations, as modified. Such modifications could include (1) opening up all or part of the volume under a contract to competitive bids, combined with access to the facility by another rail carrier; (2) revising contract rates to be commensurate with the service being provided to the facility, *i.e.,* rate reductions as a penalty for degradation of service after a merger; (3) revision of contract service standards to be consistent with agency regulations; and (4) termination of contracts and substitution with prescribed rates for arrangements that are materially inconsistent with the Board's policies regarding competition and service and which place the shipper at an extreme competitive disadvantage in its particular industry.

III.

Conclusion

In conclusion, Western strongly supports the Board's initiative to consider revising its regulations to provide for the enhancement of rail competition as the rail industry consolidates further. As part of implementing this policy, STB must incorporate into its formal merger rules provisions exercising the authority of the Board to modify existing rail transportation contracts in order to achieve this policy goal.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I have served on this 16th day of May, 2000 a copy of the above Comments by first class mail postage pre-paid, to all parties of record.

Aimee DePew